

# ANALYSIS OF AMENDED BILL

## Franchise Tax Board

Author: Florez Analyst: Jeani Brent Bill Number: AB 1610  
Related Bills: See Legislative History Telephone: 845-3410 Amended Date: 01/03/2000  
Attorney: Patrick Kusiak Sponsor: \_\_\_\_\_

**SUBJECT:** Sales or Use Tax Paid For Qualified Property Used Within Enterprise Zone Credit/Index Dollar Limit

DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended \_\_\_\_\_.

☒ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced/amended \_\_\_\_\_.

FURTHER AMENDMENTS NECESSARY.

DEPARTMENT POSITION CHANGED TO \_\_\_\_\_.

REMAINDER OF PREVIOUS ANALYSIS OF BILL AS INTRODUCED/AMENDED \_\_\_\_\_ STILL APPLIES.

☒ OTHER - See comments below.

### SUMMARY OF BILL

This bill would increase the limitation on the cost of property that qualifies for the enterprise zone sales or use tax credit to account for inflation from 1984 to 1999 and would provide for an annual inflation adjustment based upon changes in the California Consumer Price Index (CCPI).

This analysis is based upon the attached technical amendments that have been provided to the author. The author's staff stated that they would accept these amendments.

### SUMMARY OF AMENDMENT

The January 3, 2000, amendments deleted the provisions of the bill as introduced (relating to a credit for marginal oil well production) and added the provisions discussed in this analysis.

### EFFECTIVE DATE

As a tax levy, this bill would become effective immediately upon enactment and would apply to taxable and income years beginning on or after January 1, 2000.

### LEGISLATIVE HISTORY

**SB 2023** (Ch. 955, Stats. 1996) repealed the enterprise zone and program area tax incentives and replaced them with new enterprise zone incentives that were a combination of the incentives provided under the previous programs. **SB 200** (Ch. 609, Stats. 1997) amended the enterprise zone incentives to clarify that taxpayers operating in Manufacturing Enhancement Areas (MEA) are not allowed the

#### Board Position:

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<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

#### Department Director

#### Date

Alan Hunter for G.H.G.

01/10/00

enterprise zone incentives. **AB 2798** (Ch. 323, Stats. 1998) modified the income apportionment rules for the enterprise zone sales or use tax credit to a two-factor formula based on California-sourced income and expanded the definition of qualified property to include data processing and communication equipment and motion picture manufacturing equipment. **SB 1229** (Ch. 987, Stats. 1999) made a technical correction.

#### SPECIFIC FINDINGS

**Under the Government Code, existing state law** provides for the designation of enterprise zones, Local Agency Military Base Recovery Areas (LAMBRA), a Targeted Tax Area (TTA), and MEAs. Using specified criteria, the TCA designates these economic development areas from the applications received from the local governing bodies.

**Under the Revenue and Taxation Code, existing state law** provides special tax incentives for taxpayers conducting business activities within economic development areas. These incentives include a sales or use tax credit, hiring credit, business expense deduction, and special net operating loss treatment. Two additional incentives include a net interest deduction for businesses that make loans to businesses within the enterprise zones and a tax credit for employees working in an enterprise zone.

#### Sales or Use Tax Credit

The sales or use tax credit is allowed for an amount equal to the sales or use taxes paid on the purchase of qualified property purchased for exclusive use in an economic development area (except MEA). The amount of the credit is limited to the tax attributable to economic development area income. Qualified property is defined as follows:

##### *Enterprise Zone and TTA:*

- Machinery and machinery parts used for:
  - manufacturing, processing, assembling, or fabricating;
  - producing renewable energy resources; or
  - air or water pollution control mechanisms.
- Data processing and communication equipment.
- Certain motion picture manufacturing equipment.

##### *LAMBRA:*

- high technology equipment (e.g., computers);
- aircraft maintenance equipment;
- aircraft components; or
- certain depreciable property.

In addition, qualified property must be purchased and placed in service before the economic development area designation expires. The maximum cost of property that may be eligible for the enterprise zone, LAMBRA, and TTA sales or use tax credit is \$1 million for taxpayers filing under the Personal Income Tax Law (PITL) and \$20 million for taxpayers filing under the Bank and Corporation Tax Law (B&CTL).

**This bill, as proposed to be amended,** would increase the limitation on the cost of property qualified for the enterprise zone sales or use tax credit by a factor

of 1.62 to account for inflation from 1984 to 1999 and provide for an annual inflation adjustment based upon changes in the CCPI. (The limitation amounts for taxable or income years beginning during 2000 would increase from \$1 million and \$20 million to \$1,620,000 and \$32,400,000, respectively.)

**This bill, as proposed to be amended,** would require the California Department of Industrial Relations to transmit to the department on or before August 1 of each year the percentage change in the CCPI for all items from June of the prior calendar year to June of the current calendar year. The department would use this information to determine the indexed limitation amount.

#### Policy Consideration

This bill would create an additional difference between enterprise zones and the other economic development areas with the sales or use tax credit (LAMBRAs and TTAs). Recently, legislation in this area has tended toward conforming the tax incentives provided to the various economic development areas.

#### Implementation Consideration

Implementation of this bill, as proposed to be amended, would occur during the department's normal annual system update.

#### Technical Considerations

The attached amendments would accomplish the goals of modifying the enterprise zone sales or use tax credit as follows:

- For taxable or income years beginning during 2000, increase the limitation amount on the total cost of qualified property to account for inflation from June 1984 to June of 1999. This would be accomplished by multiplying the current limit by a factor of 1.62. Under the PITL, the limitation amount would be increased from \$1 million to \$1,620,000. Under the B&CTL, the limitation amount would be increased from \$20 million to \$32,400,000.
- Index the increased limitation amount annually thereafter for taxable or income years beginning on or after January 1, 2001.
- Include the changes to the same credit under the PITL.

#### FISCAL IMPACT

##### Departmental Costs

This bill, as proposed to be amended, would not significantly impact the department's costs.

##### Tax Revenue Estimate

Assuming this bill, as proposed to be amended, would increase the magnitude of applied sales and use tax credits by 5%, the revenue loss would be on the order of \$2 million annually beginning in 2000-01.

Any possible changes in employment, personal income, or gross state product that might result from this measure are not taken into account.

Tax Revenue Discussion

According to department data, the total amount of applied sales and use tax credits for enterprise zone activity was nearly \$20 million for tax year 1996. It is projected for year 2000, that applied enterprise zone sales and use tax credits under current law will increase to approximately \$40 million. The reason for the significant increase is the repeal of the Los Angeles Revitalization Zone (LARZ). Taxpayers in formerly overlapping enterprise zone and LARZ areas now will generate only new enterprise zone incentives, which will increase the amount of enterprise zone credits claimed.

BOARD POSITION

Pending.

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FRANCHISE TAX BOARD'S  
PROPOSED AMENDMENTS TO AB 1610  
As Amended January 3, 2000

AMENDMENT 1

Strike out lines 1 and 2 of the title and insert:

An act to amend Sections 17053.70 and 23612.2 of the Revenue and Taxation

AMENDMENT 2

On page 1, strikeout lines 1 and 2, strikeout pages 2 through 13, inclusive, on page 14, strikeout lines 1 through 9, and insert:

Section 17053.70 of the Revenue and Taxation Code is amended to read:

17053.70. (a) There shall be allowed as a credit against the "net tax" (as defined in Section 17039) for the taxable year an amount equal to the sales or use tax paid or incurred during the taxable year by the taxpayer in connection with the taxpayer's purchase of qualified property.

(b) For purposes of this section:

(1) "Taxpayer" means a person or entity engaged in a trade or business within an enterprise zone.

(2) "Qualified property" means:

(A) Any of the following:

(i) Machinery and machinery parts used for fabricating, processing, assembling, and manufacturing.

(ii) Machinery and machinery parts used for the production of renewable energy resources.

(iii) Machinery and machinery parts used for either of the following:

(I) Air pollution control mechanisms.

(II) Water pollution control mechanisms.

(iv) Data processing and communications equipment, including, but not limited, to computers, computer-automated drafting systems, copy machines, telephone systems, and faxes.

(v) Motion picture manufacturing equipment central to production and postproduction, including, but not limited to, cameras, audio recorders, and digital image and sound processing equipment.

(B) The total cost of qualified property purchased and placed in service in any taxable year that may be taken into account by any taxpayer for purposes of claiming this credit shall not exceed one million dollars (\$1,000,000). The limitation specified in this subparagraph shall be recomputed pursuant to subdivision (h).

(C) The qualified property is used by the taxpayer exclusively in an enterprise zone.

(D) The qualified property is purchased and placed in service before the date the enterprise zone designation expires, is no longer binding, or becomes inoperative.

(3) "Enterprise zone" means the area designated as an enterprise zone pursuant to Chapter 12.8 (commencing with Section 7070) of Division 7 of Title 1 of the Government Code.

(c) If the taxpayer has purchased property upon which a use tax has been paid or incurred, the credit provided by this section shall be allowed only if qualified property of a comparable quality and price is not timely available for purchase in this state.

(d) In the case where the credit otherwise allowed under this section exceeds the "net tax" for the taxable year, that portion of the credit that exceeds the "net tax" may be carried over and added to the credit, if any, in succeeding taxable years, until the credit is exhausted. The credit shall be applied first to the earliest taxable years possible.

(e) Any taxpayer who elects to be subject to this section shall not be entitled to increase the basis of the qualified property as otherwise required by Section 164(a) of the Internal Revenue Code with respect to sales or use tax paid or incurred in connection with the taxpayer's purchase of qualified property.

(f)(1) The amount of the credit otherwise allowed under this section and Section 17053.74, including any credit carryover from prior years, that may reduce the "net tax" for the taxable year shall not exceed the amount of tax that would be imposed on the taxpayer's business income attributable to the enterprise zone determined as if that attributable income represented all of the income of the taxpayer subject to tax under this part.

(2) Attributable income shall be that portion of the taxpayer's California source business income that is apportioned to the enterprise zone. For that purpose, the taxpayer's business income attributable to sources in this state first shall be determined in accordance with Chapter 17 (commencing with Section 25101) of Part 11. That business income shall be further apportioned to the enterprise zone in accordance with Article 2 (commencing with Section 25120) of Chapter 17 of Part 11, modified for purposes of this section in accordance with paragraph (3).

(3) Business income shall be apportioned to the enterprise zone by multiplying the total California business income of the taxpayer by a fraction, the numerator of which is the property factor plus the payroll factor, and the denominator of which is two. For purposes of this paragraph:

(A) The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in the enterprise zone during the taxable year, and the denominator of which is the average value of all the taxpayer's real and tangible personal property owned or rented and used in this state during the taxable year.

(B) The payroll factor is a fraction, the numerator of which is the total amount paid by the taxpayer in the enterprise zone during the taxable year for compensation, and the denominator of which is the total compensation paid by the taxpayer in this state during the taxable year.

(4) The portion of any credit remaining, if any, after application of this subdivision, shall be carried over to succeeding taxable years, as if it were an amount exceeding the "net tax" for the taxable year, as provided in subdivision (d).

(g) The amendments made to this section by ~~the act adding this subdivision~~ Chapter 323 of the Statutes of 1998 shall apply to taxable years beginning on or after January 1, 1998.

(h)(1) For any taxable year beginning on or after January 1, 2000, and before January 1, 2001, the limitation described in subparagraph (B) of paragraph (2) of subdivision (b) shall be multiplied by a factor of 1.62.

(2) For taxable years beginning on or after January 1, 2001, and before January 1, 2002, and within each calendar year thereafter, the Franchise Tax Board shall recompute the limitation described in subparagraph (B) of paragraph (2) of subdivision (b). That computation shall be made as follows:

(A) The California Department of Industrial Relations shall transmit annually to the Franchise Tax Board the percentage change in the California Consumer Price Index for all items from June of the prior calendar year to June of the current calendar year, no later than August 1 of the current calendar year.

(B) The Franchise Tax Board shall do both of the following:

(i) Compute an inflation adjustment factor by adding 100 percent to the percentage change figure that is furnished pursuant to subparagraph (A) and then dividing the result by 100.

(ii) Multiply the amount of the preceding year's limitation applicable for purposes of subparagraph (B) of paragraph (2) of subdivision (b) by the inflation adjustment factor determined in clause (i) and round off the resulting product to the nearest one dollar (\$1).

Section 23612.2 of the Revenue and Taxation Code is amended to read:

23612.2. (a) There shall be allowed as a credit against the "tax"(as defined by Section 23036) for the income year an amount equal to the sales or use tax paid or incurred during the income year by the taxpayer in connection with the taxpayer's purchase of qualified property.

(b) For purposes of this section:

(1) "Taxpayer" means a corporation engaged in a trade or business within an enterprise zone.

(2) "Qualified property" means:

(A) Any of the following:

(i) Machinery and machinery parts used for fabricating, processing, assembling, and manufacturing.

(ii) Machinery and machinery parts used for the production of renewable energy resources.

(iii) Machinery and machinery parts used for either of the following:

(I) Air pollution control mechanisms.

(II) Water pollution control mechanisms.

(iv) Data processing and communications equipment, including, but not limited to, computers, computer-automated drafting systems, copy machines, telephone systems, and faxes.

(v) Motion picture manufacturing equipment central to production and postproduction, including, but not limited to, cameras, audio recorders, and digital image and sound processing equipment.

(B) The total cost of qualified property purchased and placed in service in any income year that may be taken into account by any taxpayer for purposes of claiming this credit shall not exceed twenty million dollars (\$20,000,000). The limitation specified in this subparagraph shall be recomputed pursuant to subdivision (h).

(C) The qualified property is used by the taxpayer exclusively in an enterprise zone.

(D) The qualified property is purchased and placed in service before the date the enterprise zone designation expires, is no longer binding, or becomes inoperative.

(3) "Enterprise zone" means the area designated as an enterprise zone pursuant to Chapter 12.8 (commencing with Section 7070) of Division 7 of Title 1 of the Government Code.

(c) If the taxpayer has purchased property upon which a use tax has been paid or incurred, the credit provided by this section shall be allowed only if qualified property of a comparable quality and price is not timely available for purchase in this state.

(d) In the case where the credit otherwise allowed under this section exceeds the "tax" for the income year, that portion of the credit which exceeds the "tax" may be carried over and added to the credit, if any, in the following year, and succeeding years if necessary, until the credit is exhausted. The credit shall be applied first to the earliest income years possible.

(e) Any taxpayer who elects to be subject to this section shall not be entitled to increase the basis of the qualified property as otherwise required by Section 164(a) of the Internal Revenue Code with respect to sales or use tax paid or incurred in connection with the taxpayer's purchase of qualified property.

(f)(1) The amount of credit otherwise allowed under this section and Section 23622.7, including any credit carryover from prior years, that may reduce the "tax" for the income year shall not exceed the amount of tax which would be imposed on the taxpayer's business income attributable to the enterprise zone determined as if that attributable income represented all of the income of the taxpayer subject to tax under this part.

(2) Attributable income shall be that portion of the taxpayer's California source business income that is apportioned to the enterprise zone. For that purpose, the taxpayer's business income attributable to sources in this state first shall be determined in accordance with Chapter 17 (commencing with Section 25101). That business income shall be further apportioned to the enterprise zone in accordance with Article 2 (commencing with Section 25120) of Chapter 17, modified for purposes of this section in accordance with paragraph (3).

(3) Business income shall be apportioned to the enterprise zone by multiplying the total California business income of the taxpayer by a fraction, the numerator of which is the property factor plus the payroll factor, and the denominator of which is two. For purposes of this paragraph:

(A) The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in the enterprise zone during the taxable year, and the denominator of which is the average value of all the taxpayer's real and tangible personal property owned or rented and used in this state during the taxable year.

(B) The payroll factor is a fraction, the numerator of which is the total amount paid by the taxpayer in the enterprise zone during the taxable year for compensation, and the denominator of which is the total compensation paid by the taxpayer in this state during the taxable year.

(4) The portion of any credit remaining, if any, after application of this subdivision, shall be carried over to succeeding income years, as if it were an amount exceeding the "tax" for the income year, as provided in subdivision (d).

(g) The amendments made to this section by ~~the act adding this subdivision~~ Chapter 323 of the Statutes of 1998 shall apply to income years beginning on or after January 1, 1998.

(h)(1) For any income year beginning on or after January 1, 2000, and before January 1, 2001, the limitation described in subparagraph (B) of paragraph (2) of subdivision (b) shall be multiplied by a factor of 1.62.

(2) For income years beginning on or after January 1, 2001, and before January 1, 2002, and within each calendar year thereafter, the Franchise Tax Board shall recompute the limitation described in subparagraph (B) of paragraph (2) of subdivision (b). That computation shall be made as follows:

(A) The California Department of Industrial Relations shall transmit annually to the Franchise Tax Board the percentage change in the California Consumer Price Index for all items from June of the prior calendar year to June of the current calendar year, no later than August 1 of the current calendar year.

(B) The Franchise Tax Board shall do both of the following:

(i) Compute an inflation adjustment factor by adding 100 percent to the percentage change figure that is furnished pursuant to subparagraph (A) and then dividing the result by 100.

(ii) Multiply the amount of the preceding year's limitation applicable for purposes of subparagraph (B) of paragraph (2) of subdivision (b) by the inflation adjustment factor determined in clause (i) and round off the resulting product to the nearest one dollar (\$1).